

## UBS Investment Research

### Northeast Utilities

#### Doubling Down on New England

##### ■ Reiterate NU as our top pick in the transmission space

We reiterate our positive view on NU shares, with prospects for its Northern Pass transmission line gaining better traction in recent months following the support of the Boston Globe and key political players (NE governors and Canadian premiers).

##### ■ Reiterating commitment to Northern Pass, HQ contemplates further line

While some investors have expressed caution that declining power and capacity prices could drive HQ to reconsider its merchant commitment to Northern Pass (NU is developing the line on HQ's behalf). Rather, looking through the downturn, we understand HQ is early stages of exploring an *additional* expansion into ISO-NE with a ~425 MW expansion of its Highgate line into VT, up from ~225 MW.

##### ■ Dwindling fuel diversity emphasizes reliability benefits of line

New England's gas (over)-dependency was further exacerbated by ETR's decision to retire its Vermont Yankee nuclear plant, further highlighting the need for alternate regional power sources. With debate over *how to* contract for further gas pipeline in order to ensure adequate capacity in the region ongoing, the project's reliability attributes are increasingly clear. We suspect concerns over regional gas supply inadequacy will prove a potent force in swaying opinion over the line.

##### ■ Valuation: Reiterate Buy; transmission is fungible alternative to pipes

Our price target is based on a P/E SOP. With greater confidence on the project, and limited risk around revised transmission ROE, we see NU as among the best positioned transmission utilities. Moreover, risk over NH dereg remains modest under worst cases, and see limited ROE downside in a CT rate case in '14.

Highlights (US\$m)	12/11	12/12	12/13E	12/14E	12/15E
Revenues	4,466	6,274	7,213	7,244	7,360
EBIT (UBS)	836	1,118	1,549	1,611	1,726
Net Income (UBS)	423	624	804	843	915
EPS (UBS, US\$)	2.38	2.24	2.56	2.69	2.92
Net DPS (UBS, US\$)	1.10	1.31	1.45	1.57	1.69
Profitability & Valuation	5-yr hist av.	12/12	12/13E	12/14E	12/15E
EBIT margin %	15.5	17.8	21.5	22.2	23.4
ROIC (EBIT) %	12.1	12.1	12.0	12.0	12.3
EV/EBITDA (core) x	9.4	10.9	10.3	9.9	7.0
PE (UBS) x	13.9	16.7	16.2	15.4	14.2
Net dividend yield %	3.6	3.5	3.5	3.8	4.1

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E); based on a share price of US\$41.44 on 26 Sep 2013 19:39 HKT

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## Global Equity Research

Americas

Electric Utilities

12-month rating **Buy**  
*Unchanged*

12m price target **US\$48.00**  
*Unchanged*

Price **US\$41.44**

RIC: NU.N BBG: NU US

27 September 2013

#### Trading data

52-wk range	US\$45.33-37.73
Market cap.	US\$13.1bn
Shares o/s	316m (COM)
Free float	89%
Avg. daily volume ('000)	372
Avg. daily value (m)	US\$15.7

#### Balance sheet data 12/13E

Shareholders' equity	US\$9.59bn
P/BV (UBS)	1.4x
Net Cash (debt)	(US\$9.33bn)

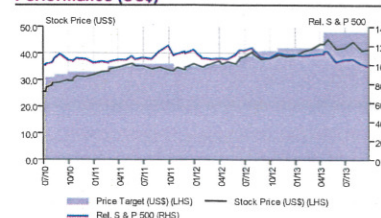
#### Forecast returns

Forecast price appreciation	+15.8%
Forecast dividend yield	3.7%
Forecast stock return	+19.5%
Market return assumption	5.3%
Forecast excess return	+14.2%

#### EPS (UBS, US\$)

	12/13E	12/12
	UBS	Cons. Actual
Q1	0.72	0.72 0.56
Q2	0.48	0.54 0.45
Q3E	0.75	0.73 0.70
Q4E	0.60	0.58 0.54
12/13E	2.56	2.55
12/14E	2.69	2.72

#### Performance (US\$)



Source: UBS

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### **Northern Pass Line Intact, Now Onto Permitting**

*Given increasing uncertainty over HQ's ability to fully contract its Northern Pass transmission line with counterparties in New England (given the more stringent limitations placed on how and when Connecticut can contract for the line through to meets its state renewable standards), we thought it worthwhile to reiterate the company's underlying commitment to develop the transmission line, even on a truly merchant basis. Rather, we believe this is a fundamental misunderstanding of HQ's development strategy, which sees the opportunity to garner premium Boston-zone (NEMA) power prices for a protracted period as a strategic imperative (amortizing the investment over a 50+ year period). Rather, in order to further enable exports of its Hydro capacity (of which it continues meaningful development both at its 1.6GW Laramie and 5GW Churchill Falls site with partners. Moreover, HQ's commitment to exporting its large-scale hydro from Canada (on a merchant basis) is not limited to New England, with HQ continuing to seriously evaluate construction of its Champlain Express (TDI) line, from Canada down into Astoria, Queens along the Hudson river. Ultimately, the project's fate lies in the hands of those granting permits rather than in doubt due to its merchant economics. Given the growing distress of the region over its inadequate supply of natural gas, we see transmission as the only readily available fungible solution to the region's energy supply in the near term. While the DOE and state permitting processes could prove bumpy in the next year, we rest relatively assured the project is particularly viable.*

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## ■ Northeast Utilities

Northeast Utilities (NU) operates New England's largest utility system, serving 3.6 million electric and natural gas customers in Connecticut, Massachusetts, and New Hampshire, as well as providing retail and wholesale transmission. NU's biggest wholesale transmission project is a \$1.4 billion HVDC line, known as Northern Pass, from Quebec to New Hampshire, that is currently in late-stage development. Northern Pass is being built with subsidiary NSTAR; NU completed its merger with NSTAR in April 2012, which added 1.1 million electric and 300,000 gas customers to the combined entity.

## ■ Statement of Risk

Investors should be aware of the following risk factors relating to NU shares: the potential impact of mild weather on regulated utility sales; unreasonable or unexpected regulatory / legal decisions; adverse FERC decisions regarding returns on transmission assets; adverse regulatory decisions for its distribution subsidiaries; and unexpected changes to the financial health of the company that could result in debt downgrades and collateral calls from counter parties. Given its aggressive transmission growth, we further highlight capital market access (both debt and equity) as imperative to its ability to execute on its plan.

## ■ Analyst Certification

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UBS 12-Month Rating	Rating Category	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	Buy	45%	35%
Neutral	Hold/Neutral	44%	37%
Sell	Sell	10%	22%
UBS Short-Term Rating	Rating Category	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Buy	less than 1%	33%
Sell	Sell	less than 1%	20%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 June 2013.

### UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

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**Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

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**Equity Price Targets** have an investment horizon of 12 months.

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**UBS Securities LLC:** Julien Dumoulin-Smith.

**Company Disclosures**

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Northeast Utilities <sup>2, 4, 6, 13, 16</sup>	NU.N	Buy	N/A	US\$41.44	26 Sep 2013

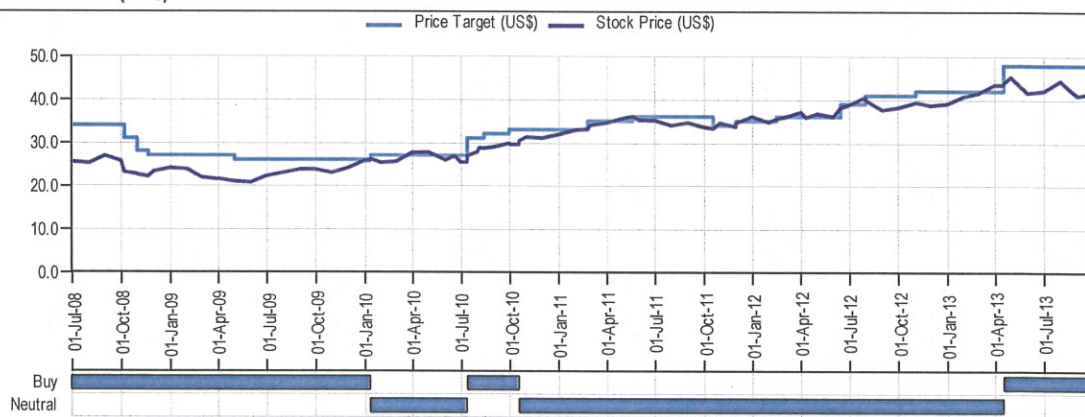
Source: UBS. All prices as of local market close.

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# Northeast Utilities (US\$)



Source: UBS; as of 26 Sep 2013

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